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REPORT No.
No. 97-646

PERIODIC PAYMENT SETTLEMENT ACT OF 1982

OCTOBER 1 (legislative day, SEPTEMBER 8), 1982.—Ordered to be printed

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Mr. DOLE, from the Committee on Finance, submitted the following

REPORT

[To accompany H.R. 5470]

The Committee on Finance, to which was referred the bill (H.R. 5470) to amend the Internal Revenue Code of 1954 to exclude from income periodic payments for damages received on account of personal injuries or sickness, and for other purposes, having considered the same, reports favorably thereon with an amendment to the text and an amendment to the title and recommends that the bill as amended do pass.

The amendment to the text of the bill is shown in italic.

House bill.—The House bill provides for an exclusion from income certain periodic payments for damages received on account of personal injuries or sickness.

Committee bill.—The bill as amended by the Committee on Finance includes the House-passed provision, and also includes amendments relating to treatment of income for certain foster care, the tax treatment of Indian tribes, and waiver of preemption in the case of Hawaii prepaid health care laws with respect to ERISA.

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I. SUMMARY

Exclusion for periodic payments

The bill excludes from gross income damage payments for injuries or sickness whether paid as lump sums or as periodic payments. Any amount received for agreeing to assume a liability for periodic payments of personal injury damages will not be included in gross income to the extent it is used to purchase an insurance annuity or a U.S. obligation to cover the liability. The provision is effective for taxable years ending after 1981.

Income for care of handicapped foster children

The bill provides that "difficulty of care payments" made to a taxpayer for his care of a handicapped foster child (under the age of 19) will be excluded from income. "Difficulty of care" payments are payments in addition to basic payments for the care of a foster child and are made as compensation for providing the additional care required by reason of a child's handicap.

Indian tribal governments

The bill extends certain tax provisions to American Indian tribal governments on the same basis as such provisions apply to States. The bill will (a) grant a deduction from Federal income tax for taxes paid; (b) provide that charitable contributions to Indian tribal governments will be deductible for income, estate, and gift purposes; (c) exempt Indian tribal governments from a variety of excise taxes (including the tax on special fuels, the manufacturers' excise taxes and the tax on the use of certain highway vehicles); and (d) provide an income tax exemption for certain governmental obligations, subject to special limitations regarding the tax treatment of industrial development bonds, issued by an Indian tribal government.

Waiver of preemption in case of Hawaiian Prepaid Health Care Act

The Hawaiian Prepaid Health Care Act was preempted by the Employee Retirement Income Security Act of 1974 (ERISA). The bill provides a limited exception to the preemption provisions of ERISA to permit the State of Hawaii to maintain its Prepaid Health Care Law as in effect on January 1, 1977. The bill also provides for cooperative agreements between officials of the State of Hawaii and the Secretary of Labor regarding preemption, and provides for a study by the Secretary of Labor of the feasibility of extending the exception to health care laws of the other States. The provision applies on the date of enactment.

II. EXPLANATION OF THE BILL

A. Exclusion for Periodic Payments (sec. 101 of the bill and sec. 104 of the Code and new Code sec. 130)

Present Law

In general, present law (Code sec. 104) excludes from gross income the following types of compensation payments for personal injuries or sickness:

(1) certain amounts received under workmen's compensation laws (if paid for personal injuries or sickness);

(2) damages received under a suit or settlement of a claim;

(3) amounts received through accident and health insurance (unless received by an employee and either attributable to employer contributions that were not includible in the gross income of the employee, or else paid directly by the employer);

(4) pensions, annuities, or similar allowances for personal injuries or sickness resulting from active service in the armed forces of any country, the Coast and Geodetic Survey, or the Public Health Service, or a disability annuity paid under the Foreign Service Act; and

(5) amounts received as disability income by a United States employee who was injured by terrorist violence while performing official duties outside the United States.

However, to avoid a double tax benefit, an exclusion is not allowed for such compensation payments to the extent attributable to (and not exceeding) deductions allowed to the recipient as medical expenses in a prior year.

Generally, the Internal Revenue Service has ruled that damages for personal injury are excludable from gross income under section 104 whether paid as a lump sum, or paid in periodic payments out of a fund invested and owned by the tortfeasor or an insurer (see Rev. Rul. 77-230, 1977-2 C.B. 214;[1] Rev. Rul. 79-220, 1979-2 C.B. 74;[2] and Rev. Rul. 79-313, 1979-2 C.B. 75[3]). However, the exclusion

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[1] Rev. Rul. 77-230 holds that distributions from a trust established and owned by the United States under a settlement agreement stemming from an individual's suit for injuries sustained at a Government facility, and requiring payment of the individual's future medical expenses from the income or corpus of the trust, are excludable from the individual's gross income. Under the facts of the ruling, any trust assets (accumulated income or corpus) remaining on the individual's death would revert to the Government.

[2] Rev. Rul. 79-220 holds that where the insurer of a tortfeasor purchases and retains exclusive ownership of a single-premium annuity contract to fund specified monthly payments for a fixed period pursuant to settlement of a damage suit for personal injuries, the recipient may exclude from his or her gross income the full amount of the payments, and not merely the discounted present value. The taxpayer's only right with respect to the amount invested was to receive the monthly payments, and the ruling concluded that the taxpayer did not have actual or constructive receipt or economic benefit of the amount invested.

[3] Rev. Rul. 79-313 holds that if, in a personal injury settlement, the insurer of a tortfeasor agrees to make 50 consecutive annual payments (increasing by 5 percent a year), the entire amount of the payments received is excludable from the recipient's gross income under section

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of damages for personal injury does not apply to investment income generated from a lump-sum award invested by or on behalf of the taxpayer (Rev. Rul. 76-133, 1976-1 C.B. 34).

Reasons for Change

Despite several revenue rulings that indicate that the Internal Revenue Service considers that periodic payments as personal injury damages are excludable from the gross income of the recipient, the committee believes it would be helpful to taxpayers to provide statutory certainty in the area. Likewise, the committee believes that a person who undertakes an assignment of the liability for such payments from the person originally liable should not include amounts received for doing so in gross income to the extent that those amounts are used merely to purchase certain types of property to specifically cover the liability.

Explanation of Provision

The bill specifically provides that the Code section 104 exclusion from gross income of damages for personal injuries or sickness applies whether the damages are paid as lump sums or as periodic payments. This provision is intended to codify, rather than change, present law. Thus, the periodic payments of personal injury damages are still excludable from income only if the recipient taxpayer is not in constructive receipt of or does not have the current economic benefit of the sum required to produce the periodic payments. See Rev. Rul. 79-220 and Rev. Rul. 77-230.

The bill also adds a new section to the Code providing that, under certain circumstances, an amount received for agreeing to undertake an assignment of a liability to make periodic payments of personal injury damages is not included in gross income. Specifically, any amount so received will not be included in gross income to the extent it is used to purchase an annuity contract of a life insurance company licensed under the laws of any State to issue such a contract or an obligation of the United States. The annuity or obligation must be designated (under regulations prescribed by the Secretary) to fund the periodic payments and the purchase must be made within 60 days before or after the date of the assignment. For example, if an assignee receives $\$100X$ for assuming the liability and only $\$98X$ is necessary to purchase an annuity or United States' obligation to fund exactly the required periodic payments, the assignee must report $\$2X$ as ordinary income. The annuity or government obligation will be considered to fund exactly the periodic payments if the amount received therefrom does not exceed the amount of the periodic payments under the assignment. Also, the period of payments under the annuity or obligation must be reasonably related to the period specified in the settlement or agreement.

In addition, this provision only applies when there is an assignment of a liability to make periodic payments of personal injury

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105(a)(2). The taxpayer did not have any right to accelerate or modify the amount of payments and the insurer was not required to set aside specific assets to secure any part of its obligation. The ruling concluded that the taxpayer did not have actual or constructive receipt, or economic benefit, of the present value of the damages.

damages if the assignee assumes the liability from a person who was a party to the suit or agreement that determined the damages and if (1) the periodic payments are fixed and determinable as to amount and time of payment; (2) the periodic payments cannot be accelerated, deferred, increased, or decreased by the recipient; (3) the assignee is subject to the same rights and liabilities as the person who assigned the liability; and (4) the periodic payments are excludable by the recipient as damages for personal injuries or sickness (sec. 104(a)(2)). Thus, an assignment by either the person originally liable (the tortfeasor) or by that person's insurance company generally will be covered by the new provision.

Finally, the new section added by the bill requires that the assignee's basis in the annuity contract (i.e., the investment in the contract for purposes of Code sec. 72) or the United States' obligation be reduced by amounts that were excluded from gross income under the new provision. Thus, under the example above, if the assignee purchases a commercial annuity for the amount necessary to fund the periodic payments (98*X*), the basis of the annuity will be reduced by $98*X* under the new provision. Also, any gain recognized on the disposition of either asset will be ordinary income. Although the assignee will have to include any amounts disbursed from the annuity or United States' obligation in gross income, the assignee will also be entitled to deduct the full amount when it is periodically paid as personal injury damages.

Effective Date

The provision is effective for taxable years ending after 1981.

Revenue Effect

The provision is expected to have a negligible impact on budget receipts.

B. Exclusion From Gross Income of Difficulty of Care Payments for Care of Handicapped Foster Children (sec. 102 of the bill and new sec. 131 of the Code)

Present Law

Except as otherwise provided by law, gross income means all income from whatever source derived (Code sec. 61). Present law, however, provides several exclusions, exemptions, and deductions from gross income. Some of these provisions apply to taxpayers who provide care for foster children. For example, the term "dependent" includes a foster child who receives over half of his or her support from the taxpayer and who, for the taxable year of the taxpayer, has as his or her principal place of abode the home of the taxpayer and is a member of the taxpayer's household (Code secs. 152(a)(9) and (b)). Thus, in certain situations, a taxpayer may claim a dependency exemption with respect to a foster child.

Revenue Ruling 77-280, 1977-2 C.B. 14, sets forth the position of the Internal Revenue Service regarding the tax treatment of amounts received and amounts expended by individuals providing foster care to children, in several different factual situations. In those situations in which foster parents are rendering gratuitous services to child-placing agencies in feeding, clothing, and caring for foster children, the ruling holds that payments received from the child-placing agency for the support of a foster child are not includible in gross income except to the extent that the payments exceed the expenses incurred by the foster parents in supporting the child. The ruling further holds that the foster parents are entitled to a charitable contribution deduction for any unreimbursed out-of-pocket expenses incurred in supporting a foster child. In those situations in which foster parents have a profit motive, the ruling holds that a portion of each payment from the child-placing agencies represents reimbursement or advancement for expenses incurred on behalf of the agency by the foster parents, and the remainder is compensation for their services.

Reasons for Change

The committee understands that some child-placing agencies make payments to foster parents that are in addition to basic payments for the care of a foster child if the foster child is handicapped. The committee believes that foster parents who receive these additional payments for the care of handicapped children generally should not be taxed thereon.

Explanation of Provision

The bill generally excludes from gross income amounts received by an individual during the taxable year as difficulty of care pay-

ments for an individual's in-home care of a handicapped foster child. This exclusion is available with respect to payments for the care of up to ten handicapped children.

Difficulty of care payments are payments that are in addition to basic payments for the care of a foster child, and that are designated by the payor as made as compensation for providing the additional care required by a handicapped foster child by reason for the child's handicap.

A handicapped foster child is a physically, mentally, or emotionally handicapped individual who is under the age of 19 and who is living in a foster family home in which he or she was placed by a child-placing agency that is operated by a State or local government or by a nonprofit agency that is exempt from tax under Code section 501(a) by reason of section 501(c)(3).

Effective Date

The provision applies to taxable years beginning after December 31, 1978.

Revenue Effect

The provision is expected to reduce fiscal year budget receipts by less than $5 million annually.

C. Treatment of Indian Tribal Governments as States for Certain Federal Tax Purposes (secs. 201–204 of the bill and secs. 103, 7701 and 7871 of the Code).

Present Law

Overview

States (including the District of Columbia) and their political subdivisions generally are exempt from Federal tax. In addition, numerous transactions by private parties with State governments and their political subdivisions result in favorable Federal tax treatment (e.g., exlcusion from gross income, tax deductions, or tax credits) for the private parties involved. Under present law, Indian tribal governments are not treated as State and local governments.

Taxation of State and local governments

State and local governments generally are exempt from the Federal income tax (Code sec. 115). In addition, State and local governments are exempt from most Federal excise taxes if an article subject to an excise tax is used exclusively for the State or local government. Among the excise taxes for which exemptions are provided are the special fuels taxes (chapter 31), the manufacturers excise taxes (chapter 32), the communications tax (chapter 33), and the highway use tax (chapter 36).

Taxation of Indian tribal governments

The Internal Revenue Code does not specifically exempt Indian tribal governments from Federal taxation; however, the Internal Revenue Service has ruled that Indian tribes are not taxable entities.[1] This ruling provides further that tribal income not otherwise exempt from Federal income tax is includible in the gross income of the Indian tribal member when distributed or constructively received by the individual. Since Indian tribal governments are not within the definition of "State" contained in the Code (sec. 7701(a) (10)), the excise tax exemptions provided for States do not apply to the tribal governments.

Special treatment of certain transactions involving State and local governments

Tax-exempt bonds.—Interest on obligations issued by or on behalf of State and local governments generally is exempt from Federal income tax. However, subject to certain exceptions, interest on State and local issues of industrial development bonds (IDBs) is taxable. An obligation is an IDB if (1) all or a major portion of the proceeds of the issue are to be used in any trade or business of a

[1] Rev. Rul. 67-284, 1967-2 C.B. 55.

person other than a governmental unit or tax-exempt organization (described in sec. 501(c)(3)), and (2) payment of principal or interest is secured by an interest in, or derived from payments with respect to, property or borrowed money used in a trade or business.

Present law provides an exception which exempts from tax interest on IDBs that are issued to finance certain types of exempt-purpose facilities. Present law also provides an exception to the general rule of taxability for interest paid on IDBs for certain "small issues." The interest on small issue IDBs is exempt if the proceeds are used for the acquisition, construction, or improvement of land or depreciable property. This exception applies to issues of $1 million or less. At the election of the taxpayer, the limitation may be increased to $10 million, subject to certain restrictions. Finally, tax-exempt financing is permitted for student loans and organizations that qualify for tax exemption under section 501(c)(3), such as private, nonprofit hospitals and private, nonprofit educational institutions.

State and local taxes.—Certain State and local taxes are deductible for Federal income tax purposes whether or not they are paid or incurred in a business context (sec. 164). This provision applies to real property taxes, personal property taxes, income taxes, and general sales taxes. A credit against Federal estate tax is available for limited amounts of State death taxes (sec. 2011). Also, a partial credit against the Federal unemployment tax is allowed for State unemployment tax (secs. 3302–3303).

Charitable contributions.—Charitable contributions generally are deductible for income tax purposes (sec. 170). A contribution to or for the use of a State or political subdivision is a charitable contribution, but only if the contribution is made for "exclusively public purposes" (sec. 170(c)(1)). Similarly, such contributions are deductible for estate tax and gift tax purposes (secs. 2055, 2106(a)(2), and 2522).

Unrelated business income.—A tax is imposed on the unrelated business taxable income of certain types of organizations that generally are exempt from income taxation (sec. 511). Although this tax generally does not apply to State or local governments or their instrumentalities (see sec. 115), the tax does apply to colleges and universities which are agencies or instrumentalities of governments or political subdivisions or which are owned or operated by governments or political subdivisions or by their agencies or instrumentalities (sec. 511(a)(2)(B)).

Excise taxes on prohibited transactions by public charities and private foundations.—An excise tax is imposed on certain public charities that make "excess" expenditures to influence legislation. The term "legislation" is defined to include "action with respect to Acts, bills, resolutions, or similar items by the Congress, any State legislature, any local council, or similar governing body, or by the public in a referendum, initiative, constitutional amendment, or similar procedure" (sec. 4911(e)(2)).

Present law also includes a series of restrictions on activities of private foundations, restrictions on "self-dealing," and on "taxable expenditures." The self-dealing rules generally prohibit payments to government officials, a term which includes anyone holding "elective or appointive public office" in the government of a State,

a political subdivision, "or other area of any of the foregoing," if that person is receiving gross compensation at an annual rate of $15,000 or more, and also includes a personal or executive assistant or secretary to any such office-holder. The taxable expenditure rules generally prohibit expenditures to influence legislation. Treasury regulations define "legislation" for purposes of this provision to include "action * * * by any State legislature [or] by any local council or similar governing body * * *" (Treas. Reg. § 53.4945–2(a)(2)).

Credit for the elderly.—People who receive retirement income from public retirement systems and have not yet attained age 65 are entitled to credits against income tax under rules different from those applying generally to people 65 or older (sec. 37). A pension, annuity, retirement, or similar fund or system established by a State or political subdivision is a "public retirement system" under these provisions.

Eligibility for certain tax-deferred annuities.—Present law provides that an employee who performs services for an educational institution may exclude from income amounts paid by his or her employer under certain types of annuity arrangements ("tax-sheltered annuities"), if the employer is "a State, a political subdivision of a State, or an agency or instrumentality of one or more of the foregoing" (sec. 403(b)(1)(A)(ii)).

Political campaign contributions.—An individual is allowed a nonrefundable credit (sec. 41) against income tax of 50 percent of his or her political contributions and newsletter fund contributions made during the taxable year, with a maximum credit of $50 ($100 on a joint return). Eligible recipients of political contributions include political parties and individuals who are candidates for nomination or election to any Federal, State, or local elective public office. The Code defines "local" to mean "a political subdivision or part thereof, or two or more political subdivisions or parts thereof, of a State."

Scholarship and fellowship grants.—Generally, scholarships and fellowships are excluded from gross income of the recipients (sec. 117). Only a limited exclusion is available in the case of a recipient who is not a candidate for a degree at an educational institution, and even that limited exclusion is available only if the grantor meets one of several tests. A State or political subdivision thereof is an eligible grantor under this provision.

Special treatment of certain transactions involving Indian tribal governments

Because Indian tribal governments are not treated like State governments for tax purposes, the favorable consequences available to private parties entering into transactions with State governments generally are unavailable for those transactions entered into with the tribal governments. [2] The excise taxes on certain prohibited transactions by charities with State governments likewise do not apply.

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[2] Sec. 4225 of the Code exempts from manufacturers excise tax any article of native Indian handicraft produced by Indians on Indian reservations, in Indian schools, or by Indians under the jurisdiction of the U.S. Government in Alaska.

Reasons for Change

Many Indian tribal governments exercise sovereign powers; often this fact has been recognized by the United States by treaty. With the power to tax, the power of eminent domain, and police powers, many Indian tribal governments have responsibilities and needs quite similar to those of State and local governments.

Increasingly, Indian tribal governments have sought funds with which they could assist their people by stimulating their tribal economies and by providing governmental services.

The committee has concluded that, in order to facilitate these efforts of the Indian tribal governments that exercise such sovereign powers, it is appropriate to provide these governments with a status under the Internal Revenue Code similar to what is now provided for the governments of the States of the United States. The committee understands this would be of greatest significance at this time in the area of gifts or contributions to Indian tribal governments, exemptions with respect to excise taxes, the deductibility of income taxes paid to these governments, and the ability of these governments to issue tax-exempt bonds. A number of other points have been presented as to which the committee also agrees that Indian tribal governments should be treated essentially the same as State governments. Although these points (such as credits or deduction for political campaign contributions and the income tax status of fellowship grants to individuals who are not candidates for degrees) are of lesser significance at present, the committee has concluded that they, too, should be dealt with in this legislation.

Explanation of Provisions

Status as governmental unit

The bill provides that, for a series of specified purposes under the Internal Revenue Code, Indian tribal governments are to be treated the same as States or similar to States. The Code provisions amended by this bill generally provide that political subdivisions of States are to be treated essentially the same as the States themselves.

Although the statutory term for the kind of entity to be benefitted by the bill is "Indian tribal government", the bill applies to certain governments of Alaska Natives as well as Indians and applies whether the entity is characterized as a tribe or as a band, community, village, or group. The rules of the bill are not to apply to any Indian tribal government unless it is recognized by the Treasury Department (after consultation with the Interior Department) as exercising sovereign powers. Sovereign powers include the power to tax, the power of eminent domain, and police powers (such as control over zoning, police protection, and fire protection).

The Internal Revenue Code provisions dealt with in this bill generally provide that political subdivisions of States are to be treated essentially the same as the States themselves. Under the bill, a subdivision of an Indian tribal government is to be treated as a political subdivision of a State for the purposes specified in the bill if (and only if) the Treasury Department determines (after consultation with the Interior Department) that the subdivision of the

Indian tribal government has been delegated the right to exercise one or more of the sovereign powers of the Indian tribal government. It is intended that essentially equivalent criteria be used in making determinations as to delegations of sovereign powers by Indian tribal governments to their subdivisions and delegations of sovereign powers by States to their political subdivisions.

If such a determination is made, that is to be sufficient to cause the subdivision to be treated as a political subdivision of a State. It is not necessary for a whole range of sovereign powers to be delegated, in order for the subdivision to be treated as a political subdivision of a State; it is sufficient if at least one sovereign power has been so delegated. Also, it is not necessary that the subdivision in fact exercise that power at any given time, so long as the Indian tribal government has in fact delegated to the subdivision the right to exercise the power. A sovereign power, in order to be taken into account for purposes of these rules, must be one that is capable of practical exercise. For example, the power of eminent domain over privately owned land is not to be taken into account if none of the land within the jurisdiction of the subdivision is privately owned. As is explained more fully below in the section on tax-exempt bonds, many agencies or instrumentalities of Indian tribal governments probably will not qualify as political subdivisions but may nevertheless be permitted to issue tax-exempt bonds "on behalf of" their Indian tribal governments.

The committee intends that the Internal Revenue Service will from time to time publish lists of those tribes and subdivisions that have been recognized as exercising sovereign powers. The publication of such lists will serve functions similar to those served by the Service's "blue book" of organizations eligible to receive deductible charitable contributions (Cumulative List of Organizations Described in Section 170(c) of the Internal Revenue Code of 1954, Publication 78). A listing in such a publication generally should enable people such as potential charitable donors, potential bond purchasers, or potential political campaign contributors to contribute or purchase with the expectation that the intended tax benefits will be available.[1]

Taxation of Indian tribal governments

The bill does not amend the present income tax treatment of Indian tribal governments specified in Rev. Rul. 67-284, *supra.* (i.e., otherwise taxable income of the tribe is taxable when distributed to tribe members).

However, under the bill, most Federal excise taxes do not apply to articles sold for the exclusive use of Indian tribal governments.

Under the bill, excise taxes on liquids sold for use as fuels are not to apply in the case of sales for the exclusive use of any Indian tribal government or subdivision. Also, use of any such liquid by

[1] In many cases, additional requirements have to be met before the tax benefits may be obtained. For example, a deductible contribution to an Indian tribal government must be for exclusively public purposes; an Indian tribal government's bond issue must satisfy the requirements of the rules described below in order for the interest on it to be exempt from Federal income tax, and a candidate for tribal office must meet the requirement of announcement of candidacy for elective public office in order for a contribution to his or her campaign to be eligible for a credit or deduction.

any such government or subdivision is to be exempt from the special fuels taxes.

Under the bill, a sale by a manufacturer of any article is exempt from the manufacturers excise taxes if the sale is to an Indian tribal government or a subdivision of such a government for the exclusive use of such a government or subdivision. As is the case with State and local governments under present law, the exemption applies even though the sale is to one government for the use of another. For example, if a manufacturer sells otherwise taxable articles (such as trucks or gasoline) to an Indian tribal government, the exemption is to apply whether the sale is for the exclusive use of that government or for the exclusive use of a subdivision of that government. Because under present law States are exempt in their capacities as consumers but not in their capacities as manufacturers, Indian tribes will also be exempt under these provisions as consumers but not as manufacturers. However, this provision is not to be interpreted in such a manner as to affect any exemption under present law section 4225 with respect to articles of native Indian handicraft.

The bill exempts from the communications tax any communication services and facilities furnished to an Indian tribal government or a subdivision of such a government. The other taxes on services (transportation of persons or property by air) do not provide exemptions for State or local governments and are not affected by this bill.

The bill exempts from the highway use tax any use of a highway motor vehicle by any Indian tribal government or subdivision of such a government.

The bill does not amend the provisions of chapter 45, relating to the crude oil windfall profit tax, to treat Indian tribal governments as State governments for purposes of that tax.

Subtitle F of the Code includes a number of provisions relating to credits or refunds of excise taxes where the tax was collected and paid even though the exemption applied. Under the bill, those credit or refund provisions are to apply in the case of a tax-paid sale to an Indian tribal government or a subdivision of such a government for the exclusive use of such a government or subdivision, in the same manner as they are applied to corresponding sales to a State or political subdivision.

Special treatment of certain transactions involving Indian tribal governments

Tax-exempt bonds.—The bill provides that Indian tribal governments are to be treated generally the same as States (and tribal subdivisions are to be treated generally the same as political subdivisions of States) for purposes of the tax-exempt bond interest provisions. However, the bill includes a number of restrictions on this treatment of Indian tribal governments with respect to commercial or industrial activities or other activities other than essential governmental functions. The purpose of those restrictions is generally either (1) to allow the profits from such activities to be exempt from Federal income tax (because of the basic Federal income tax exemption of Indian tribes and because section 115 does not apply to Indian tribes) or (2) to allow the interest on the obligations

where the proceeds are used in such commercial or industrial activities to be exempt from Federal income tax, but not to allow both of these income tax benefits to apply in any one case. As a result, the bill permits Indian tribal governments to issue tax-exempt bonds for essential governmental purposes and also tax-exempt bonds which are industrial development bonds for private purposes. However, the bill places restrictions on both categories of bonds. These provisions do not permit an Indian tribal government (or subdivision) to issue tax-exempt bonds under circumstances where a corresponding issue by a State (or political subdivision) would not be tax-exempt.

Many agencies or instrumentalities of Indian tribal governments probably will not qualify as political subdivisions, but may nevertheless be permitted to issue tax-exempt bonds "on behalf of" their Indian tribal governments. See Treas. Regs. § 1.103-1(b). For example, an Indian tribal government may establish a separate power authority and authorize the power authority to issue obligations on behalf of the Indian tribal government. Obligations issued by the power authority pursuant to that authorization are to be treated as having been issued on behalf of the Indian tribal government under the same circumstances that obligations issued by a State power authority would be treated as having been issued on behalf of the State government.

If all of a major portion of the proceeds of an Indian tribal government's obligation are to be used, directly or indirectly, in one or more commercial or industrial activities (or other activities other than essential governmental functions) conducted by the tribe, then the interest on the obligation is not to be exempt from Federal income tax. For purposes of the exemption of interest on certain industrial development bonds, a commercial or industrial activity which is only nominally the activity of a party other than the Indian tribe is to be treated as the activity of the tribe. Therefore, the interest on bonds used to finance such activities will not be eligible for tax-exemption under section 103.

The bill permits one exception to this rule—where an Indian tribal government (or a subdivision of that government) issues an obligation the proceeds of which are to be used in a utility-type activity. The bill provides that this exception applies only if the activity provides substantially all of its service on that tribe's reservation.

A utility-type activity includes the furnishing or sale of electrical energy, gas, water, or sewage disposal services. It does not include air or water pollution control facilities unless they are a part of the normal operation of what would otherwise be a utility-type activity.

The bill provides special requirements for Indian tribal governments that issue tax-exempt industrial development bonds. These requirements are in addition to the requirements applicable to other issuers of such bonds.

The first requirement is two-fold—(1) the principal activities of the trade or business (whether the trade or business is a new business or is an existing business) must be carried on within the reservation of the Indian tribal government which issued the obligation (or whose subdivision issued the obligation), and (2) if there are off-

reservation activities of that trade or business, substantially all of these off-reservation activities must be purchasing, marketing, or similar activities directly related to the on-reservation activities.

Second, the bill includes a new rule for applying the dollar limits that are imposed on small-issue industrial development bonds.

Under the bill, where there are no county boundaries (or boundaries of incorporated municipalities) on a reservation, the Treasury Department may (after consulting with the Interior Department) prescribe ranges of sizes for areas on the reservation that might be treated as counties (or incorporated municipalities) for the purpose of applying the small issue rules. These size ranges are to be determined so that the tax benefits of these rules, as applied to any reservation, are approximately equal to the tax benefits of these rules, as applied to the counties (and incorporated municipalities) in the same general area of the country as the reservation.

Also, under the bill, if part of a county (or incorporated municipality) is within a reservation and part is not, then each part is to be treated as a separate county (or incorporated municipality).

For purposes of the tax-exempt interest provisions, a tribe's reservation generally is the area reserved by treaty, Federal statute, or executive order for that tribe. In addition, where the Secretary of the Interior designates an area as a reservation for a tribe, that area is to be treated as that tribe's reservation for these purposes.

State and local taxes.—The bill provides that Indian tribal governments are to be treated as States for purposes of the deduction for taxes under section 164. As a result, if a tax imposed by an Indian tribal government falls into any of the categories of taxes that may be deducted under section 164 if imposed by a State, then the Indian tribal government tax is also deductible for Federal income tax purposes. Similarly, a tax imposed by a subdivision of an Indian tribal government is to be treated as a "local tax" under the rules of section 164.

Charitable contributions.—The bill provides that an Indian tribal government is to be treated as a State for purposes of determining whether contributions or transfers to or for the use of the tribal government are deductible for income tax purposes (under sec. 170), estate tax purposes (under secs. 2055 and 2106(a)(2), and gift tax purposes (sec. 2522). The requirement in each case that the gift be made for "exclusively public purposes" is to be applied in such a manner as to make it comparable to the effect of that requirement as applied to State governments. Similarly, subdivisions of Indian tribal governments are to be treated for these purposes in the same manner as political subdivisions of States.

Unrelated business income.—Under the bill, a college or university which is an agency or instrumentality of an Indian tribal government or a subdivision of such a government or which is owned by such a government or subdivision is to be subject to the unrelated business income tax in the same manner as a college or university that is similarly related to a State or political subdivision.

Excise taxes on prohibited transactions by public charities and private foundations.—The bill provides that legislation dealt with by Indian tribal governments and subdivisions is within the purview of the tax on excess lobbying expenditures in the same manner as legislation dealt with by States and political subdivi-

sions. Where the governing body of the tribe performs both legislative functions and other governmental functions (executive, judicial), this provision is to be applied so as to make it comparable in effect to the application of the present statutory provisions to county councils and other governing bodies that perform both legislative and nonlegislative functions. Similarly, the rules applicable to communications with nonlegislative branch officials or employees (sec. 4911(d)(2)(E)) are to be applied with respect to Indian tribal governments and their subdivisions in such a manner as to have the same effect as the application of these rules to equivalent officials and employees of State governments and their political subdivisions.

Additionally, the restrictions on self-dealing between private foundations and government officials are, under this bill, to apply to officials of Indian tribal governments and their subdivisions in the same manner as they apply under present law to government officials of States. As described above, with respect to public charities, the restrictions on private foundations influencing legislation similarly are to apply to tribal legislation in the same manner as those restrictions now apply to State legislation.

Credit for the elderly.—Under the bill, an Indian tribal government (or subdivision) is to be treated as a State (or political subdivision) for purposes of determining whether a person who is younger than 65 is receiving retirement income under a "public retirement system". Such a person may be entitled to a "credit for the elderly" against income tax even though he or she is younger than 65. This provision is to be applied so as to treat under-65 retirees from Indian tribal government employment comparably with retirees from State government employment.

Eligibility for certain tax-deferred annuities.—Under the bill, an Indian tribal government (or subdivision) is to be treated as a State (or political subdivision) for purposes of determining whether an employer is permitted to purchase "tax-sheltered annuities" for its employees. States, their political subdivisions, and agencies or instrumentalities of States or their political subdivisions are permitted to enter into such tax-sheltered arrangements for their employees who perform services for educational institutions.

Political campaign contributions.—Under the bill, an Indian tribal government (or subdivision) is to be treated as a State (or political subdivision) for purposes of determining whether contributions to candidates, committees, parties, or office-holders may be treated as "political contributions" or "newsletter fund contributions", which can give rise to income tax credits or deductions.

Scholarship and fellowship grants.—Under the bill, an Indian tribal government (or subdivision) is to be treated as a State (or political subdivision) for purposes of applying the Code provisions allowing exclusions from income taxation for scholarships and fellowships for individuals who are not candidates for degrees at educational institutions. As a result, an Indian tribal government (or subdivision) will be a permissible donor of a scholarship or fellowship that is excludible from income under the limitations of section 117(b)(2).

Effective Dates

The provisions relating to income taxes (other than those relating to tax-exempt bonds) apply to taxable years beginning after December 31, 1982; the provisions relating to tax-exempt bonds apply to obligations issued after the date of enactment.

The estate and gift tax provisions of the bill are to apply to estates of decedents dying after December 31, 1982, and to gifts made after that date.

The excise tax provisions (including the excess lobbying expenditures tax of chapter 41 and the private foundations taxes of chapter 42) are to take effect on January 1, 1983. That is, these provisions are to apply to events occurring on or after that date.

Revenue Effect

It is estimated that these provisions will reduce budget receipts by less than $10 million annually.

D. Waiver of Preemption in Case of Hawaiian Prepaid Health Care Act (sec. 301 of the bill and sec. 514(b) of ERISA)

Present Law

The Employee Retirement Income Security Act of 1974 (ERISA) provides comprehensive rules relating to employee benefit plans, including plans providing health benefits to employees. The Act (sec. 514(a)) generally supersedes State laws insofar as they relate to employee benefit plans.

The Hawaii Prepaid Health Care Act (Haw. Rev. Stat. 393–1 through 51), provides for a program of health insurance for employees. As a result of litigation, it was determined that the Prepaid Health Care Act was preempted by ERISA (*Standard Oil Company of California* v. *Agsalud,* 633 F. 2d 760 (9th Cir. 1980), *aff'd,* 454 U.S. 801 (1981)).

Reason for Change

The committee believes that the preemption of the Hawaii Prepaid Health Care Act by ERISA was inadvertent and that ERISA should not interfere with the authority of the State of Hawaii to maintain its Prepaid Health Care Act as that Act was effective on January 1, 1977.

Explanation of Provision

The provision exempts the Hawaii Prepaid Health Care Act, as in effect on January 1, 1977, from the preemption provisions of ERISA.

Because the exception is restricted to the Hawaiian Prepaid Health Care Act as in effect on January 1, 1977, provisions of that Act made effective after that date, relating to drug and alcohol abuse treatment will continue to be preempted by ERISA. Also, the provision does not affect the status, under the preemption provisions of ERISA, of any State tax law relating to employee benefit plans.

The provision authorizes the Secretary of Labor to enter into cooperative arrangements with officials of Hawaii to assist them in effectuating the policies of laws which are superseded by ERISA. The provision also requires a study by the Secretary of Labor on the feasibility of extending the exception from ERISA preemption to include other State laws which establish health care plans. The Secretary of Labor is to report the results of this study to the Congress within 2 years after the date of enactment of the bill.

Effective Date

The provision is effective on the date of enactment.

Revenue Effect

The provision is estimated to reduce budget receipts by less than $5 million annually.

III. COSTS OF CARRYING OUT THE BILL AND VOTE OF THE COMMITTEE IN REPORTING H.R. 5470

Budget Effects

In compliance with paragraph 11(a) of Rule XXVI of the Standing Rules of the Senate, the following statement is made relative to the budget effects of H.R. 5470, as reported.

Budget receipts

The table below summarizes the estimates of the effects on budget receipts of the provisions of the bill for fiscal years 1983–87:

[Fiscal years; millions of dollars]

Provision	1983	1984	1985	1986	1987
Exclusion for periodic payments (sec. 101)	(1)	(1)	(1)	(1)	(1)
Income for care of handicapped foster children (sec. 102)	(2)	(2)	(2)	(2)	(2)
Indian tribal governments (secs. 201–205)	(3)	(3)	(3)	(3)	(3)
Waiver of preemption in case of Hawaiian Prepaid Health Care Act (sec. 301)	(3)	(3)	(3)	(3)	(3)

[1] Negligible revenue impact.
[2] Loss of less than $10 million.
[3] Loss of less than $5 million.

The Treasury Department agrees with this statement.

Budget outlays

The bill involves no budget outlays.

Vote of the Committee

In compliance with paragraph 7(c) of Rule XXVI of the Standing Rules of the Senate, the following statement is made relative to the vote by the committee on the motion to report the bill. H.R. 5470, as amended, was ordered favorably reported by voice vote.

IV. REGULATORY IMPACT OF THE BILL AND OTHER MATTERS TO BE DISCUSSED UNDER SENATE RULES

A. Regulatory Impact

Pursuant to paragraph 11(b) of Rule XXVI of the Standing Rules of the Senate, the committee makes the following statement concerning the regulatory impact that might be incurred in carrying out the provisions of H.R. 5470, as reported.

Numbers of individuals and businesses who would be regulated

The bill does not involve new or expanded regulation of individuals or businesses.

Economic impact of regulation on individuals, consumers, and business

The bill provides for an exclusion for certain periodic payments for personal injuries, treats Indian tribal governments as State or local units for tax purposes, exempts certain foster care income, and amends ERISA with respect to waiver of preemption in the case of Hawaii prepaid health care laws.

Impact on personal privacy

The bill does not relate to the personal privacy of individuals.

Determination of the amount of paperwork

The bill will involve little, if any, additional paperwork for taxpayers.

B. Other Matters

Consultation with Congressional Budget Office on budget estimates

In accordance with section 403 of the Budget Act, the committee advises that the Director of the Congressional Budget Office has examined the committee's budget estimates of the tax provisions of the bill (as shown in Section III of this report) and agrees with the methodology used and the committee's budget estimates.

New budget authority

In compliance with section 308(a)(1) of the Budget Act, and after consultation with the Director of the Congressional Budget Office, the committee states that the changes made to existing law by the bill involve no new budget authority.

Tax expenditures

In compliance with section 308(a)(2) of the Budget Act with respect to tax expenditures, and after consultation with the Director of the Congressional Budget Office, the committee states that the

changes made to existing law by the provisions relating to tax treatment of Indian tribal governments involve tax expenditures of less than $10 million annually.

V. CHANGES IN EXISTING LAW MADE BY THE BILL, AS REPORTED

In the opinion of the committee, it is necessary, in order to expedite the business of the Senate, to dispense with the requirements of paragraph 12 of Rule XXVI of the Standing Rules of the Senate (relating to the showing of changes in existing law made by the provisions of H.R. 5470, as reported by the committee).